

**INTERNATIONAL CIVIL AVIATION ORGANIZATION  
AIRPORT PRIVATIZATION SEMINAR FOR THE NAM/CAR/SAM REGIONS  
(GUATEMALA CITY, 13-16 DECEMBER 1999)**

**PRIVATIZATION IN THE PROVISION OF AIRPORTS  
AND AIR NAVIGATION SERVICES**

by

**Tulsi R. Kesharwani  
Consultant  
International Civil Aviation Organization  
Montreal**

**1. GENERAL**

- 1.1 Privatization in the provision of airport and air navigation services, especially the former, commenced as a part of globalization and liberalization of the economies of the world and a general move towards privatization of commercially oriented industries and services which were hitherto managed by States. Privatization of air navigation services is following privatization of airport services in a limited number of States but is presently in its infancy.
- 1.2 The pressure for privatization in the provision of airport and air navigation services has mainly come not from the managers of airport and air navigation services but from the owners, that is, the government.
- 1.3 This presentation primarily deals with privatization in the provision of airport services. However, where considered appropriate, references will be made to the provision of air navigation services.

**2. ICAO POLICY ON ORGANIZATIONAL STRUCTURE**

- 2.1 Presently, airports and air navigation services in different States are operated under various organizational formats. Considering the diverse circumstances involved, ICAO does not recommend one organizational format over another but rather it provides guidance to States by describing relevant aspects of each format. However, keeping in view the experience gained worldwide, ICAO recommends that governments may wish to explore the possibility of establishing autonomous authorities to operate their airports and air navigation services where this is in the best interest of providers and users. (*Statements by the Council to Contracting States on Charges for Airports and Air Navigation Services* (Doc 9082/5) paragraphs 6 and 27 refer).

- 2.2 In regard to private involvement in airport ownership and management, ICAO advises for example that privatization may offer significant benefits in certain cases. However, privatization requires careful consideration of a number of factors. Fundamental among these is that an airport is in essence a monopoly on which the users - aircraft operators, passengers and shippers are highly dependent. Consequently, a number of safeguards must be implemented before proceeding with privatization. (See *Airport Economics Manual* Doc 9562 paragraph 2.28)

### 3. **OVERVIEW AND TRENDS IN PRIVATIZATION**

- 3.1 Privatization in the provision of airport services has been witnessed in all the continents. It has been making rapid progress in Europe and Latin America, with a slower process in North America, Asia (notably Southeast Asia), Middle East and Africa.
- 3.2 While in Europe the privatization process is progressing through sale of equity, in Latin America, Australia and in some other countries it is through leases for varying periods.
- 3.3 Privatization in the provision of air navigation services has not been seriously considered in most of the States. These services are considered as more connected with safety of aircraft operations, and to have national defense and external relation implications, and consequently less suited for privatization. Air navigation services are also perceived as closely related to sovereignty of State as it provides for aircraft and air carriers of foreign States to enter national airspace.

### 4. **DRIVING FORCES BEHIND PRIVATIZATION**

#### 4.1 **Financial considerations**

- 4.1.1 Financing of airport infrastructure by the States is becoming increasingly difficult because of pressure to finance other high priority services, especially social services. In some States, past neglect due to financial difficulties has led to general deterioration of airport infrastructure and the States are unable to rectify the situation.
- 4.1.2 Due to continuous increases in air traffic, large investments which the States are unable to find are required to create additional capacities. Moreover, in the 21<sup>st</sup> century airports are expected to be increasingly costly, especially in relation to the purchase or lease of land. The expectations of the airlines and other users in regard to the quality of service are growing. The new airports may be costly not only to develop but also to operate.
- 4.1.3 Governments are realizing that they can readily pass the burden of financing airport development programmes to the private sector, where the traffic volumes are relatively high.

- 4.1.4 Airport privatization has been seen by certain governments as a source of revenue to cover or reduce budgetary deficits. Profit making airports can be a regular source of tax revenues.
- 4.1.5 Recent good financial bids received from privatization of certain airports have provided encouragement to States to privatize.

#### 4.2 **Changes in the outlook of governments towards airport management**

- 4.2.1 Presently, the approach of governments generally is that they should move away from non-core public utility activities and airport is considered as a non-core sector. The airports, at least the major ones, are considered more as commercial entities than public utilities. Larger airports are turning into cities in themselves with their market places and meeting points for people and business.
- 4.2.2 There is a general perception that privatization can lead to improvement in the management of airports, although this may not always be the case, especially because the airports are essentially monopolies .

#### 4.3 **Gradual emergence of global airport management industry**

- 4.3.1 The general realization of the business community and the financiers that with a monopoly situation, continuous growth in traffic and strong cash flows, an airport can be a sound investment proposition and consequently there is a gradual emergence of a global airport management industry. Investors do realize that they are subject to government regulations but commercial activities at airports, which produce significant revenues, are not regulated.

### 5. **TERMS USED IN THE CONTEXT OF PRIVATIZATION**

- 5.1 In the context of privatization in the provision of airport services, a number of different terms or phrases are currently being used. Some common ones are:
  - Privatization
  - Private participation/Private involvement
  - Corporatization
  - Commercialization
  - Business principles
  - Joint sector participation /Joint ventures
  - Wraparound addition
  - Long-term lease/Short-term lease
  - Build, Operate and Transfer (BOT.)
  - Build, Own, Operate and Transfer (BOOT)
  - Build, Transfer and Operate (BTO)

- Buy, Build and Operate (BBO)
- Build, Own and Operate (BOO)
- Lease, Develop and Operate (LDO)
- Management contracts
- Perpetual franchising
- Sale of equity/full share flotation/partial share flotation/outright trade sale/freehold sale

5.2 The above terms and phrases represent different levels of privatization. Some terms may denote the same or similar meaning.

5.3 ICAO is in the process of adopting and developing clear definitions of these and other terms with a view to assisting understanding.

## 6. MAJOR STAGES OF PRIVATIZATION

### 6.1 Government-owned enterprises

This includes:

- (a) an autonomous corporation;
- (b) a company with 100 percent equity held by government; and
- (c) a commercial enterprise responsible for management of airport and/or air navigation services.

(The present concept of privatization, which is much more advanced than in the past, does not include these systems of ownership and management. It should, however, be noted that under these systems the approach to management is closer to private sector management.

### 6.2 Private sector participation/involvement

This includes:

- (a) private sector participation/ involvement in development and management of airport facilities or air navigation services with less than 50 percent stake in equity;
- (b) relatively short and medium-term leases for less than 20 years; and
- (c) management contracts.

(Similarly, these categories of airports may not be strictly considered as privatized as private sector has minority or limited stake.

### 6.3 Privatized airports

This includes:

- (a) airports with more than 51 percent private sector stake in equity;
- (b) outright trade sale /freehold sale ; and
- (c) long term leases for more than 20 years.

(Very strictly, airports under lease, short or long term should not be considered as privatized, as the ownership is not transferred.)

## 7. OPTION FOR STATES

7.1 Broadly, the States have the following options, apart from direct control of ownership and management of airports by government.

Sr. no.	Major option	Sub-option
(a)	Government ownership	(1) An autonomous corporation established under the provisions of a special statute (2) A public limited company with all the shares held by government (3) An enterprise established by an administrative order
(b)	Management contracts	Management contracts can be for shorter or longer periods
(c)	Leases	(1) Short-term or medium term leases (less than 20 years) (2) Long term leases (over 20 years) (BOT and its several derivatives are leasing arrangements)
(d)	Private sector minority participation in equity	Private sector participation limited to less than 50 percent stake in equity
(e)	Private sector ownership and control	(1) Private sector participation with more than 50 percent stake in equity (2) Outright sale of airport

## 8. PROS AND CONS OF OPTIONS

- 8.1 Under option (a) in para seven above, airports and air navigation services basically remain under the overall ownership of government but the management is transferred to another organization, which is generally autonomous in financial and operational matters. However, the autonomy can be restricted. A government organization is generally expected to serve the public interest better as profit is not its motive and the objective is to serve public interest. This option may provide flexibility to States in ensuring development of airports to suit its political, social and economic requirements from time to time.
- 8.2 Under option (b) the management of airport is transferred to a private professional entity for a limited period of time. The ownership of the airport remains with the government. The concerned airport benefits from professional management but under this option the professional manager does not undertake development of the airport from its own funds. This option may be suitable for the airports, which have limited development requirements but wish to improve management.
- 8.3 Under option (c) the airport remains the property of the government but is transferred for management and development to a private entity for a fixed period. On the expiry of the fixed period the airport is returned to the lessor. During the period of the lease the private entity keeps all the revenues, defrays all operational expenses and retains the profits. The private entity pays to the lessor, which is mainly government, certain predetermined lease money or a concession fee. The development works at the airport are generally undertaken by the private entity at its own cost. Under the lease system, the government retains the ownership, at least psychologically. However, under this system the arrangement is final and the lessee is fixed for a predetermined period. For an arrangement with a longer lease period, the amount of lease money can be expected to be higher.
- 8.4 Under option (d) the ownership of airport is partially transferred to the private sector. Under this system the government has the option of deciding from time to time what proportion of ownership or equity to retain for itself and what to transfer to the private sector. The advantage is that the transfer of ownership can be in stages. In developing countries, unless the management is also transferred to the private sector, wherein a foreign investor has a major stake, transfer of partial ownership may not attract investors from foreign countries.
- 8.5 Under the last option (e) the majority ownership of the airport is transferred to the a private entity or the airport is sold like any other commodity. However, once the equity shares are transferred, it may not be possible to get the airport back unless the government decides to buy back the shares and private investors are prepared to sell. In such an event the government may have to pay a higher price. Outright sale option could be considered for smaller airports with little economic importance. This is not a common option and requires the existence of a regulatory body to ensure that the interest of aircraft operators, passenger and the State at large are protected.

## 9. APPLICATION OF OPTIONS

- 9.1 All these options are being exercised in different parts of the world to a greater or lesser degree. This is so because political, social and economic environments differ from country to country. Moreover, the volume of air traffic and financial viability, which can considerably influence the choice of ownership and management option, differ from airport to airport.
- 9.2 The available data do not establish that one particular option is better than another option. What is best for a State depends upon the situation in the State, including volume of traffic and its growth potential, condition of the existing infrastructure, improvement and expansion requirements, access to capital markets, managerial expertise available and the overall policy of the government to changes in the ownership and management of infrastructure.
- 9.3 One particular option may cover some or all the airports, either individually or in groups. In the same State it is possible to have one option for one set of airports and another option for another set of airports. For States with limited air transport development, air navigation services may also be considered for inclusion in the preferred option along with airports. Under each option variations are possible.
- 9.4 It has to be noted that airports (and air navigation services) are a service industry, the primary objective of which is to provide safe, secure, efficient and economical service to the airlines, passengers and other users. The ownership and management structure of the airport should be considered as a means to achieve this end. However, financial and operational autonomy is key to success of ownership and organizational structure. Moreover, in a privatized regime economic regulation as well as safety and security regulation will be very important. Furthermore, it seems certain that in future there will be increasing dependence of the States on the private sector for financing major airports and also air navigation services capital development programmes, irrespective of the choice of ownership and management option.

## 10. SOME SPECIAL FEATURES OF AIRPORT INFRASTRUCTURE

- 10.1 Airport infrastructure has certain special features, different from other industries and even from other transport infrastructure. So long as it is managed by government or government controlled organizations, these special features can be taken care of. However, if the airport is to be owned and managed by the private sector, where the primary objective is to maximize return on investment, certain safeguards are essential and the industry needs to be suitably regulated to safeguard the interest of various stakeholders.
- 10.2 As major airports, which are considered for privatization, tend to be international airports, such airports basically serve international traffic between two or more States. Accordingly, operations involve bilateral or multilateral agreements between States. For such agreements ICAO provides

guidance on certain principles and rules with regard to cost recovery (Article 15 of Convention on Civil Aviation, Statements by the Council to Contracting States on Charges for Airports and Air Navigation Services, Doc 9082/5).

- 10.3 The airlines operate in the air but they use the airports for landing and take off, which are considered critical phases of flight. Accordingly, airports play a major role in the safety and security of airline operations. By the nature of the operations and the users, safety and security are accorded a very high priority, and a considerable part of the expenses of the airport infrastructure relates to it.
- 10.4 Airports are monopolistic in character. In certain States, such as small landlocked States with a single international airport, or States separated from other by water or physical barriers, airports play a critical role in the economy.

## 11. MAJOR ISSUES TO BE CONSIDERED IN CHOOSING OPTIONS

- 11.1 If a State wishes to consider change in the ownership or management structure of its airports, a number of issues will require to be considered. While considering such issues airport management should be involved at every stage of the process. It is also necessary to be clear about the short-term and long-term objective of the change. Some of the initial issues, which require consideration, are:
- < Examine in depth the present stage of the airport infrastructure in the country and the problems faced by it, including financial and managerial problems.
  - < Prepare a detailed profit and loss account of the airports and the air navigation services separately, make a forecast for the future, if feasible for the next twenty years. It may be desirable to prepare such forecasts for individual airports, which are considered for privatization. Also, make an assessment of the capital development requirements and the possible options to meet financial and managerial needs.
  - < If privatization is considered as an option, decide what services and facilities are to be privatized and the method of privatization.
  - < Also consider what is to be done for the remaining services.
- 11.2 It is to be noted that the private sector is essentially interested in profit making facilities or facilities which have the potential to make profit. It may be possible to tag some unprofitable airports to profitable airports so long as there is overall profitability, although care must be taken to ensure that this does not prejudice international non-discrimination principles.



## 12. **PRIVATIZATION OF AIR NAVIGATION SERVICES**

- 12.1 For the successful management and operation of air navigation services, financial and operational autonomy is important as for airports. However, a more cautious approach is required in privatizing air navigation services as safety and other important issues are involved to a greater extent.

## 13. **LEGAL AND REGULATORY ASPECTS**

- 13.1 For a change in the ownership and management structure of airports or air navigation services, changes in national laws may be necessary. It can be done by amending the existing laws or enacting a new legislation. The nature of legislative action will depend upon the provisions of the existing laws, rules and regulations and the selected option. The new laws apart from enabling the government to make changes in the ownership and management, should enable the government to restructure the remaining civil aviation organization.
- 13.2 ICAO, which is the international regulatory body for civil aviation, has developed Standards and Recommended Practices to assist States in ensuring safety of operations. Periodic inspections and audit of aerodrome facilities are required by the aerodrome operator and the regulator. Safeguards regarding environment, which includes noise abatement, emissions, water, sewage, fuel storage, and waste disposal should be adequately provided for.
- 13.3 It needs to be ensured that the monopoly power which an airport provides is not misused. Sometimes, an unregulated monopoly may be more harmful than a relatively inefficient public monopoly. International obligations, such as freedom of access, non-discrimination between categories of users, ICAO cost recovery policies, principles and procedures, etc. especially in regard to air traffic charges, should be honoured. There may be a need to have some control over other charges and the quality of services to be provided by the private operator.
- 13.4 Regulations come at a price because they place constraints on the flexibility of the private operator. Discretionary powers with the States in the regulations increase the risks of the private operator and these may lead to higher expectations of return on investment and possibly lesser value for the State. It is important that regulations should be the minimum necessary and precise. Wherever discretionary powers are unavoidable, the principles or guidelines, to the extent possible, should be laid down. Ideally, the regulatory authority should be an independent entity.
- 13.5 The overall objective of the State should be to balance the interests of various stakeholders including private investor, passengers, airlines, business interests, local communities and wider public at large.

#### 14. **PRIVATIZATION PROCESS**

14.1 Privatization of airports can be a relatively detailed and complicated process for a State, if it has to ensure that a suitable party is selected for management of airports. The project has to be carefully handled and not implemented in a hurried manner. Government should provide all possible information to the potential bidders so that they understand the situation and offer realistic bids. The selected operator should be well-reputed, financially sound and experienced. An extraordinary high financial bid should be viewed with caution and detailed explanation should be asked from the bidder before such a bid is accepted. Preferably, bidding should be in two stages, one to shortlist the suitable parties and the other to invite financial bids.

#### 15. **RISKS TO STATES IN PRIVATIZATION**

15.1 Every business activity has certain risks and airports cannot be an exception. The major risks are:

- The leasing entity may become bankrupt.
- The private entity may ignore safety requirements.
  - If a group of airports is owned or managed by one private entity, the entity may ignore the developmental needs of those airports which are likely to yield less profitable results.
  - The private entity may increase the charges too much, which may not be in the best interest of the State or region.
  - The private entity may not honour the committed lease payments.
  - The private entity may pressurize the State to renegotiate the terms of lease, after quoting unrealistic payments terms or if the expected traffic does not materialize.

15.2 If the contract documents have been well prepared, the risks can be minimized.

#### 16. **REORGANIZATION OF CIVIL AVIATION STRUCTURE**

16.1 The existing civil aviation structure will need to be reorganised consequent to the changes in the ownership and management structure of certain facilities and services. The nature and extent of reorganisation will primarily depend upon what remains with the government after the change over.

16.2 In a normal situation only a few airports will be privatized and the remaining airports and air navigation services may continue with the government. The options can be:

- Keep the remaining airports and air navigation services with the government. This option may be preferred by States with limited traffic.
- Create an autonomous entity for the provision of airports and air navigation services with a commitment from the government to meet financial needs to cover the deficits and capital development requirements.
- An autonomous entity can manage air navigation services, and other airports may continue with the government.
- It is also possible to privatize the remaining airports and select a party, which demands the least subsidy.

16.3 Under all the options regulatory powers need to be kept either with the government or with an independent authority. In larger countries, it may be desirable to have an independent authority. However, as the regulatory requirements may increase in a privatized regime, the unit in the government dealing with regulatory issues will need to be strengthened.

## **17. ASSISTANCE OF CONSULTANT**

17.1 It is now an accepted principle that the selection of the private investor should be made through an open bidding or tendering procedure in a transparent manner.

17.2 Since privatization in the provision of airport services is a complex process in which the governments, especially in developing countries, may not have sufficient expertise, it may be desirable and advantageous to obtain the advice of one or more outside consultants. In so doing, however, it is important that every effort be made to ensure that the consultant selected is thoroughly knowledgeable in the area of expertise.

17.3 Also, it needs to be ensured that the consultant has no affiliation with the bidders for airports. Airport management should work closely with the consultant, regularly monitor the work and carefully review the resultant reports. It has to be noted that the consultant is only an adviser and all the decisions will have to be taken by the government.

## 18. CONCLUSION

- 18.1 Airports (and air navigation services) are a service industry, the primary objective of which is to provide safe, secure, efficient and economical services to the airlines, passengers, shippers and other users. There are several alternative ownership and management options for the provision of the services and such options should be considered as means to achieve the end result. The available evidence does not clearly establish the best option. Accordingly, a State should choose the option, which is best suited for it in achieving the above objectives. It should, however, be noted that; (a) the selected option should provide for relatively financial and operational autonomy; (b) the industry will need to be suitably regulated and; (c) in future, the industry is likely to be increasingly dependent upon the private sector for financing capital development programmes.

— END —